

— July 16, 2004 —



# Audit Oversight

Quality Control Review of  
PricewaterhouseCoopers, LLP and  
the Defense Contract Audit Agency  
Office of Management and Budget  
Circular A-133 Audit Report of the  
Institute for Defense Analyses, Fiscal  
Year Ended September 28, 2001  
(D-2004-6-007)

— Department of Defense —  
Office of the Inspector General

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## **Acronyms**

DCAA	Defense Contract Audit Agency
FFRDC	Federally Funded Research and Development Center
GAS	Government Auditing Standards
IDA	Institute for Defense Analyses
OIG	Office of the Inspector General
OMB	Office of Management and Budget
PwC	PricewaterhouseCoopers, LLP
QCR	Quality Control Review
SEFA	Schedule of Expenditures of Federal Awards



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
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July 16, 2004

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Branch Manager  
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Defense Contract Audit Agency

**SUBJECT:** Report on Quality Control Review of PricewaterhouseCoopers, LLP and the Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the Institute for Defense Analyses, Fiscal Year Ended September 28, 2001 (Report No. D-2004-6-007)

We are providing this report for your information and use. The audit firm of PricewaterhouseCoopers, LLP (PwC) and the Defense Contract Audit Agency (DCAA) performed the FY 2001 single audit for the Institute for Defense Analyses (IDA), located in Alexandria, Virginia. Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," (OMB Circular A-133) requires the audit. IDA expended \$133.8 million in Federal awards under the Research and Development Cluster for DoD Federally Funded Research and Development Centers (FFRDC) during the fiscal year that ended September 28, 2001.

**Background.** IDA is a not-for-profit organization that manages DoD-sponsored FFRDCs. Founded in 1947 as the Weapons Systems Evaluation Group, IDA was incorporated in 1956 and has its headquarters in Alexandria, Virginia, with sites in Norfolk, Virginia; Princeton, New Jersey; San Diego, California; and Bowie, Maryland. IDA employees specialize in national security issues, computer software and engineering, strategy and force assessments, operational test and evaluation, research in civil space, expert systems for criminal investigation, and energy and environmental issues.

The PwC office in Washington, D.C., has provided audit services to IDA since the early 1960s. The DCAA office in Columbia, Maryland, has provided OMB Circular A-133 audit services to IDA since FY 1998. PwC and DCAA coordinated and accepted certain audit responsibilities for the FY 2001 single audit of IDA. Details on the division of audit responsibilities for the single audit are discussed in Appendix B.

**Quality Control Review Objective.** As the cognizant Federal agency for IDA, the Office of the Inspector General of the Department of Defense (OIG DoD) performed a Quality Control Review (QCR) of the single audit report and supporting audit documentation for the FY 2001 IDA single audit. The objectives of the review were to

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determine whether the audit was conducted according to generally accepted auditing standards, *Government Auditing Standards* (GAS), and the auditing and reporting requirements of OMB Circular A-133. We also reviewed corrective actions taken by PwC as a result of a QCR we performed on the FY 1998 single audit of IDA (see OIG DoD Report Number D2000-6-008, “Quality Control Review of PricewaterhouseCoopers LLP, for OMB Circular A-133 Audit Report for Institute for Defense Analyses, Fiscal Year Ended September 25, 1998,” August 14, 2000).

**Review Results.** The DCAA auditors did not plan and perform the FY 2001 single audit to ensure compliance with auditing standards and the guidance and requirements in OMB Circular A-133 and its related Compliance Supplement. As a result, the auditors did not properly identify and test the Special Tests and Provisions compliance requirement, follow up on omissions from the Schedule of Expenditures of Federal Awards (SEFA), and sufficiently document the basis for assessing that the Program Income and Subrecipient Monitoring compliance requirements were not applicable (Finding A).

The DCAA auditors did not document audit work in accordance with Government Auditing Standards and DCAA audit guidance. Because, in certain instances, the audit procedures were not sufficiently documented, we could not rely solely on the working papers to determine whether there was sufficient evidence to support the auditors’ opinion and conclusions. As a result, DCAA auditors were required to provide extensive verbal explanations to demonstrate that the auditors performed the appropriate sampling and followup audit procedures, and for us to determine whether the audit documentation supported all the facts and conclusions in the single audit report (Finding B).

The DCAA report opinion on compliance with Federal program requirements and the report on the SEFA were not prepared in accordance with auditing standards and the requirements of OMB Circular A-133. As a result of the DCAA departure from the standard reporting language, it is unclear whether the scope of the DCAA audit met the Circular requirements (Finding C).

The IDA audit report generally met the reporting requirements in OMB Circular A-133; however, the SEFA did not include all the information required by OMB Circular A-133. As a result, Federal program officials may not be able to fully use the SEFA in their monitoring efforts (Finding D).

The PwC audit of the financial statements generally met the applicable auditing standards and OMB Circular A-133 requirements. During our review we discussed opportunities for enhancements to audit documentation with the audit team. In addition, PwC auditors adequately implemented corrective actions in response to recommendations in our QCR of the FY 1998 single audit of IDA. These issues are discussed in the “Other Matters of Interest” section of this report.

**Management Comments and Reviewer Response.** Management concurred, or concurred in principle, with the recommendations. Comments from the Branch Manager, DCAA Chesapeake Bay Branch Office and the Treasurer, IDA were responsive; therefore, no additional comments are required. Management Comments are discussed in the findings and are included in their entirety at the end of this report.

**Finding A. Audit Planning and Performance.** The DCAA auditors did not plan the audit to include testing of the DoD FFRDC sponsoring agreement provisions. As a

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result, they incorrectly determined that the Special Tests and Provisions compliance requirement was not applicable and they did not perform sufficient procedures to determine whether the SEFA was complete. In addition, the audit documentation did not provide enough information to determine whether the auditors performed sufficient procedures to support the conclusion that the Program Income and Subrecipient Monitoring requirements were not applicable.

**Special Tests and Provisions Compliance Requirement and the Review of the Schedule of Expenditures of Federal Awards.** DCAA incorrectly determined that the Special Tests and Provisions compliance requirement was not applicable based on a limited review of IDA contracts and on discussions with IDA personnel. The auditors should have reviewed the FFRDC sponsoring agreements. However, the audit documentation does not indicate that the auditors reviewed the agreements. The requirement for an FFRDC to have a written sponsoring agreement is in the Federal Acquisition Regulation Subpart 35.017, “Federally Funded Research and Development Centers” and the “Department of Defense Federally Funded Research and Development Center (FFRDC) Management Plan.” The sponsoring agreements are required to have, among other things, provisions that delineate procedures and limitations that the FFRDC is subject to. Both sponsoring agreements contained such provisions related to work performed by IDA for “nonsponsor” entities.

As a result of the failure to review the sponsoring agreement, the auditors did not follow up on a discrepancy identified in the review of the SEFA. Required by OMB Circular A-133 §\_\_\_\_\_.310(b), the SEFA is a schedule prepared by Federal award recipients. The SEFA must include all Federal awards as defined in the Circular and is the basis for the auditor’s risk assessment process that determines which Federal award programs are included in the single audit.

The DCAA auditors performed limited procedures in the review of the SEFA. As a result of those audit procedures, however, the auditors identified a \$309,000 difference between the SEFA and the audited financial statements. DCAA documented that this difference was not material and did not perform any additional procedures. However, in the course of our review, we identified an indirect cost submission schedule prepared by IDA and reviewed by the DCAA auditors that included expenditures of approximately \$311,000 for four programs annotated as “non-DoD.” DCAA did not perform audit procedures to determine whether these programs were properly excluded from the SEFA or whether the “non-DoD” work complied with the FFRDC sponsoring agreements procedures and limitations for “nonsponsor” activity.

As a result of these deficiencies in audit planning and performance, the single audit report does not assure the DoD sponsor program administrators that IDA has complied with sponsoring agreement requirements. In addition, program administrators for the “non-DoD” awards may not be aware of the amount of funds actually expended. DCAA auditors need to perform additional audit procedures to determine whether IDA was in compliance with the FFRDC sponsoring agreement provisions and whether the SEFA is complete. DCAA auditors also need to revise the FY 2001 single audit report if necessary based on the results of the additional work.

### **Applicability of Program Income and Subrecipient Monitoring**

**Requirements.** The DCAA audit documentation did not support the determination made by DCAA that Program Income and Subrecipient Monitoring requirements were not applicable.

**Program Income.** DCAA auditors determined the Program Income compliance requirement was not applicable to IDA based on limited testing and discussions with IDA personnel. The DCAA auditor based the determination on the review of a contract that began in FY 2001 and the results of the prior fiscal year single audit. As a result of the supervisory review, the auditor was directed to review the FY 2001 audited financial statements for indications of program income. The documentation states that based on this review DCAA did not identify any program income, and therefore, no further audit procedures were performed.

We retested the auditor's conclusion on the review of the FY 2001 financial statements and found that the financial statements identified approximately \$10,000 in "miscellaneous income." However, there was no documentation to demonstrate that the auditor performed procedures to determine the source or nature of the "miscellaneous income" in order to conclude that it was not related to a program funded with Federal award dollars. As a result of the lack of documentation, we were unable to determine the exact basis for the conclusion that the program income requirement was not applicable and whether it was supported by sufficient evidence.

**Subrecipient Monitoring.** DCAA auditors determined that the requirement to monitor subrecipients was not applicable because IDA did not provide more than \$300,000 in pass-through awards to any individual non-profit entity during FY 2001. As a result of this determination, the auditors did not perform any audit procedures to test IDA responsibility under OMB Circular A-133 § \_\_\_\_\_.400(c)(3) to monitor subrecipients.

The auditor's justification for determining that the subrecipient monitoring requirement was not applicable is incorrect because it was based on a misinterpretation of OMB Circular A-133 requirements. The \$300,000 referenced by the auditor relates to the threshold amount that establishes the requirement for an entity to have a single audit. The Circular does not establish a threshold requirement for monitoring subrecipients. OMB Circular A-133 § \_\_\_\_\_.400(c)(3) requires the monitoring of subrecipient activities "as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements...." Furthermore, the Circular requires the auditor to determine whether the auditee has complied with requirements that have a direct and material effect on major programs.

During discussions with the DCAA auditors, the auditors stated that the subrecipient monitoring requirement was not applicable because IDA did not provide funding to other entities "to carry out a program," but rather "to provide a service to IDA." However, we were unable to find documentation of audit procedures, in support of the DCAA verbal statements, to determine the nature of the subcontractor effort. In addition, the DCAA auditors stated that the \$1.7 million paid to subcontractors was not a material amount in relation to the major program. However, the audit documentation did not contain a materiality determination, and we were unable to otherwise verify that materiality was part of the reason why DCAA determined this was not an applicable compliance requirement.

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DCAA needs to perform and document additional audit procedures, as appropriate, to ensure that the audit documentation supports the determination on the applicability and materiality for all compliance requirements.

**Recommendation A.**

A.1. We recommend that the Branch Manager, Defense Contract Audit Agency Chesapeake Bay Branch Office perform additional audit procedures for the Office of Management and Budget Circular A-133 audit report for the Institute of Defense Analyses (the Institute) for FY 2001 to determine whether the Institute is in compliance with Federally Funded Research and Development Centers sponsoring agreement requirements and if the Schedule of Federal Expenditures is complete, and provide our office with the supporting documentation. The report should be revised, if needed, based on the results of the additional audit work.

**Management Comments.** The Branch Manager, DCAA Chesapeake Bay Branch Office concurred and stated that his office will review the sponsoring agreements for special tests and provisions and take additional actions, if warranted. The Branch Manager also stated that his office will conduct additional analysis of the differences between the SEFA and the financial statements to determine whether the SEFA is properly stated and the contractor is in compliance with the provisions of the sponsoring agreements. The Branch Manager expects all additional work to be completed not later than July 31, 2004, and will provide us with supporting documentation.

A.2. We recommend that the Branch Manager, Defense Contract Audit Agency, Chesapeake Bay Branch Office perform additional procedures to determine whether the Program Income and Subrecipient Monitoring requirements are applicable. Based on the results of the additional audit work, we further recommend that any appropriate procedures be performed and the report be revised as necessary.

**Management Comments.** The Branch Manager, DCAA Chesapeake Bay Branch Office concurred and stated that his office will review all income sources in the financial statement to determine whether the Program Income and Subrecipient Monitoring compliance requirements applied in FY 2001 and, if the Program Income and Subrecipient Monitoring compliance requirements did apply, will perform additional steps to ensure that IDA complied with the Compliance Supplement. If necessary, his office will revise the report. The Branch Manager expects all additional work to be completed not later than July 31, 2004, and will provide us with supporting documentation.

**Finding B. Documentation of Audit Work.** DCAA auditors did not adequately document all relevant audit procedures and conclusions in accordance with GAS and DCAA audit guidance. Also, they did not follow DCAA quality control procedures for ensuring that the audit report statements and conclusions were supported by sufficient, competent, and relevant evidence. Specifically, DCAA audit documentation did not provide sufficient support related to the following:

- The sampling plan designed to test internal control and compliance objectives for the Cash Management, Equipment and Real Property, and Procurement compliance requirements;

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- The follow-up procedures performed to determine the reasonableness of the Summary Schedule of Prior Audit Findings; and,
- Stated references for the facts and conclusions presented in the OMB Circular A-133 draft report.

As a result, DCAA auditors were required to provide extensive verbal explanations to the OIG reviewer to demonstrate that the auditors performed the appropriate sampling and followup audit procedures. In addition, extensive verbal explanations were required for the OIG reviewer to determine whether the audit documentation supported all the facts and conclusions in the single audit report.

**Sampling Plan Design.** The auditors did not document the design of the sampling plans used to test internal control and compliance with the Cash Management, Equipment and Real Property, and Procurement requirements. Specifically, DCAA auditors did not sufficiently document the sampling plan to include the objective of the sample, a description of the sampling universe, the basis for the sample size, and the method of sample selection. As a result of the lack of documentation of the sampling plans, we needed to conduct extensive interviews with the auditors to determine that the judgmental sampling provided sufficient relevant evidence to support the audit conclusions.

**Support for the Determination on the Reasonableness of the Summary Schedule of Prior Audit Findings.** The DCAA audit documentation did not contain procedures to support the “Auditor’s Comments on Summary Schedule of Prior Audit Findings” in the FY 2001 single audit report. The FY 2001 single audit reporting package included a “Summary Schedule of Prior Audit Findings.” The report stated that DCAA auditors performed procedures to assess the reasonableness of the summary schedule and that auditors determined that the schedule accurately represented the status of corrective actions taken in response to the FY 2000 OMB Circular A-133 audit. However, according to the FY 2001 audit documentation, the auditor concluded during the course of the audit that there were no findings in the FY 2000 report and, therefore, no further procedures were necessary. Our review of the prior audit report disclosed a reported finding and recommendation related to the proposed Cost of Money Factors and prior recommendations for IDA to prepare written policies and procedures for the Labor, Accounting, and Other/Indirect Cost systems.

We discussed the inconsistency between the audit documentation and the statements in the audit report with the DCAA auditors. They advised us that the auditor incorrectly determined during audit work that there were no findings in the FY 2000 report but that this mistake was identified during the supervisory review and described procedures taken to assess the reasonableness of the IDA assertions. In addition, the DCAA auditor advised the reviewer that the auditor failed to initially identify the existence of prior audit findings because they were not reported in the FY 2000 “Schedule of Findings and Questioned Costs.” The deficiencies were, however, mentioned in the “Scope of Audit” section and discussed in more detail in the “Auditee Organization and Systems” section of the audit report.

**Stated References for Facts and Conclusions in Audit Report.** The audit documentation for the FY 2001 single audit did not include a copy of the draft report that was cross-referenced to the supporting working papers. As a result, we were unable to determine the basis for several statements in the DCAA report and had to rely on

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extensive discussions with DCAA auditors to determine whether the required audit work had been conducted. Both the DCAA Quality Control System as described in the DCAA Contract Audit Manual, Chapter 2-S10, "Engagement Performance," and the DCAA OMB Circular A-133 standard audit program require that a printed copy of the draft audit report, cross-referenced to the working papers, be retained in the audit working paper package. Completion of this requirement ensures that facts and figures are accurate and complete, and that all statements in the audit report are supported by audit documentation.

**Conclusion.** The DCAA Contract Audit Manual and the DCAA OMB Circular A-133 audit program provide auditors guidance regarding documentation of audit work. We believe the lack of implementation of existing guidance contributed to the issues discussed in both this finding and Finding A. The DCAA Headquarters Quality Assurance Division has also identified documentation issues in their reviews and has developed general training on audit documentation. All DCAA auditors will receive this training by September 30, 2004. The Branch Manager, DCAA Chesapeake Bay Branch Office also needs to ensure that the OMB Circular A-133 audit work is adequately documented, to include documentation of judgmental sampling plans and cross-referencing of draft audit reports.

**Recommendation B.** We recommend that to improve future audits, the Branch Manager, Defense Contract Audit Agency Chesapeake Bay Branch Office, ensure adequate documentation of judgmental sampling plans and audit work conducted to achieve the objectives of Office of Management and Budget Circular A-133 audits. In addition, we recommend that the Branch Manager ensure that draft audit reports are cross-referenced in accordance with Defense Contract Audit Agency guidance.

**Management Comments.** The Branch Manager, DCAA Chesapeake Bay Branch Office concurred and stated that managers have placed strong emphasis on documentation during recent staff conferences. In addition, the Branch Manager stated that his office will review current procedures and ensure that a cross-referenced version of the draft audit report is maintained in the audit documentation for future audits.

**Finding C. Reporting Inconsistent with OMB Circular A-133 Requirements.** The DCAA report opinion on compliance with Federal program requirements and the report on the SEFA were not prepared in accordance with auditing standards and the requirements of OMB Circular A-133. As a result of the DCAA departure from the standard reporting language, it is unclear whether the scope of the DCAA audit met the Circular requirements.

**Opinion on Compliance with Federal Program Requirements.** The DCAA audit report incorrectly contained a "qualified" opinion on compliance with Federal program requirements. The DCAA qualified the report due to a potential Cost Accounting Standards noncompliance issue related to the accounting for Intergovernmental Personnel Act costs. However, the information on the compliance opinion in the summary of audit results section (Schedule of Findings and Questioned Costs) was inconsistent with the "qualified" opinion in the report. The Schedule of Findings and Questioned Costs noted that the compliance opinion was "unqualified." Because the audit documentation did not support the decision to qualify the report on compliance, we discussed both the basis for the report qualification and the inconsistency in the presentation of audit results within the single audit report with DCAA personnel.

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Based on our discussions, DCAA management did not consider the noncompliance material enough to impact the overall opinion on compliance. Under those circumstances the auditor's report on compliance should have contained an "unqualified" opinion. DCAA needs to reissue the report to reflect the proper opinion on compliance with Federal program requirements.

**Report on the Schedule of Expenditures of Federal Awards.** The DCAA audit report on the SEFA does not meet the requirements of OMB Circular A-133. OMB Circular A-133 \_\_\_\_\_.505(a) requires auditors to "determine whether the SEFA is presented fairly in all material respects in relation to the auditee's *financial statements* taken as a whole" [OIG emphasis]. However, the DCAA audit report states that the SEFA "...with regard to the research and development program is fairly stated in all material respects, in relation to the *financial records* taken as a whole" [OIG emphasis]. We discussed this issue with DCAA personnel who agreed that the wording was not in accordance with the requirements but stated their belief that by auditing the financial records, they had done more work than was required. However, the auditors did not provide any further explanation to support the need to vary the report language and there was no explanation in the audit documentation. The requirement to express an opinion on the SEFA in relation to the financial statements is intended to provide assurance that the information provided to Federal agencies is not materially inconsistent with the information in the audited financial statements. DCAA auditors need to revise the FY 2001 OMB Circular A-133 audit report so that it contains the required language, or they need to provide further explanatory comments in the report as appropriate.

**Recommendation C.** We recommend that the Branch Manager, Defense Contract Audit Agency Chesapeake Bay Branch Office reissue the Office of Management and Budget Circular A-133 audit report for the Institute of Defense Analyses for FY 2001 to accurately reflect the results and conclusions of the audit and include required language.

**Management Comments.** The Branch Manager, DCAA Chesapeake Bay Branch Office concurred in principle and stated that although the auditors did not follow OMB Circular A-133 and DCAA guidance, he believed that "the usefulness of modifying and reissuing the report at this time is uncertain." The Branch Manager agreed to an alternative action whereby he would obtain written confirmation from the IDA Board of Directors or the Audit Committee of their concurrence with proposed alternative actions and provide the written confirmation to us. The Branch Manager stated in a followup conversation that he would include a statement in a "corrections page" that accurately reflects the result and conclusions of the audit and the required language if actions taken in response to Recommendations A.1., A.2., and B. necessitate such a page.

**Reviewer Response.** We consider the Branch Manager's proposed actions responsive.

**Finding D. Presentation of Schedule of Expenditures of Federal Awards.** The SEFA did not include a note that described the significant accounting policies used in preparing the schedule. OMB Circular A-133 Section §\_\_\_\_\_.310(b)(4) specifically requires this information be included in the schedule. As a result, Federal program officials may not be able to fully use the SEFA in their monitoring efforts. We discussed this requirement with IDA personnel and were advised that they were unaware of the requirement to prepare the schedule with this information and would ensure that the schedule is properly prepared in future audits.

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**Recommendation D.** We recommend that the Treasurer, Institute for Defense Analyses ensure the Schedule of Expenditures of Federal Awards includes the appropriate notes to meet the requirements of Office of Management and Budget Circular A-133 in all future single audit reporting packages.

**Management Comments.** The Treasurer, IDA concurred and will include the appropriate language in all future OMB Circular A-133 audit reports beginning with the FY 2003 report.

**Other Matters of Interest.** As a result of our QCR, we identified and discussed enhancements to audit documentation with the PwC audit team, and they agreed to implement the enhancements in future single audits. In addition, we reviewed the corrective actions taken by PwC auditors as a result of our prior QCR (OIG DoD Report Number D2000-6-008, "Quality Control Review of PricewaterhouseCoopers LLP, for OMB Circular A-133 Audit Report for Institute for Defense Analyses, Fiscal Year Ended September 25, 1998," August 14, 2000).

We determined that PwC auditors took appropriate actions to correct the deficiencies we identified during the last QCR. PwC auditors returned a portion of the fee they charged for the FY 1998 IDA single audit; initiated and continued yearly coordination with DCAA and IDA to prevent duplication of effort; enhanced the PwC-wide OMB Circular A-133 audit guide to include documenting an understanding of the five elements of internal control as they pertain to the 14 compliance requirements; and ensured that all auditors involved in OMB Circular A-133 audits obtain the required amount of continuing professional education. We commend PwC on their efforts to implement our recommendations.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877) or Ms. Janet Stern at (703) 604-8750 (DSN 664-8750). See Appendix C for the report distribution. The review team members are listed inside the back cover of the report.



Patricia A. Brannin  
Assistant Inspector General  
for Audit Policy and Oversight

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# **Appendix A. Quality Control Review Process**

## **Scope and Methodology**

We conducted a quality control review of the PwC and DCAA audit of IDA for the fiscal year ended September 28, 2001, and the resulting reporting package that was submitted to the Federal Audit Clearinghouse dated August 12, 2002. We performed our review using the 1999 edition of the “Uniform Quality Control Guide for the A-133 Audits” (the Guide). The Guide applies to any single audit that is subject to the requirements of OMB Circular A-133 and is the approved President’s Council on Integrity and Efficiency checklist used for performing quality control reviews. Our review was conducted from May 2003 through June 2004. As the cognizant agency for IDA, we focused our review on the following qualitative aspects of the single audit:

- Qualification of auditors
- Independence
- Due professional care
- Planning and supervision
- Internal control and compliance testing
- Schedule of Expenditures of Federal Awards
- Schedule of Findings and Questioned Costs
- Summary Schedule of Prior Audit Findings
- Data Collection Form

In conducting our review, we reviewed the audit documentation that PwC and DCAA prepared. We also discussed the audit with the PwC audit team; DCAA auditors; and IDA personnel.

## **Prior Quality Control Reviews**

Since October 1, 1998, we have performed six quality control reviews of PwC OMB Circular A-133 audits. One of the six reports contained deficiencies resulting in findings and recommendations on audit planning, performance, and documentation, and two reports contained suggestions for improvements to audit documentation and continuing professional education.

Since October 1, 1998, we have performed seven quality control reviews of DCAA OMB Circular A-133 audits. Four of the seven reports contained deficiencies resulting in findings and recommendations on audit planning, performance, and documentation. Our review indicates that similar deficiencies still exist.

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## **Single Audit Requirements**

The intention of the Single Audit Act, Public Law 98-502, as amended, and OMB Circular A-133 was to improve the financial management of state and local governments and non-profit organizations. The Single Audit Act and OMB Circular A-133 establish one uniform set of auditing and reporting requirements for all Federal award recipients required to obtain a single audit. OMB Circular A-133 establishes policies that guide implementation of the Single Audit Act and provides an administrative foundation for uniform audit requirements of non-Federal entities administering Federal awards. OMB Circular A-133 requires that Federal departments and agencies rely on and use the single audit work to the maximum extent practicable. Entities that expend \$300,000 or more of Federal awards in a fiscal year are subject to the Single Audit Act and the audit requirements in OMB Circular A-133 and, therefore, must have an annual single or program-specific audit performed under GAS. To meet the intent of the law and OMB Circular A-133 requirements, the auditee (non-Federal entity) submits to the Federal Audit Clearinghouse a complete reporting package and a Data Collection Form on each single audit. The submission includes the following:

- Data Collection Form, certified by the auditee that the audit was completed in accordance with the OMB Circular A-133;
- Financial statements and related opinion;
- Schedule of Expenditures of Federal Awards and related opinion;
- Report on compliance and internal control over financial reporting;
- Report on internal control over compliance for major programs;
- Report on compliance with requirements for major programs and related opinion;
- Schedule of Findings and Questioned Costs;
- Summary Schedule of Prior Audit Findings; and
- Corrective action plan, when appropriate.

The OMB Compliance Supplement (the Supplement) assists auditors to identify compliance requirements the Federal Government expects to be considered as part of the single audit. For each compliance requirement, the Supplement describes the related audit objectives that the auditor shall consider in each audit conducted under OMB Circular A-133 as well as suggested audit procedures. The Supplement also describes the objectives of internal control and characteristics that, when present and operating effectively, may ensure compliance with program requirements. The following 14 compliance requirements identified in the Supplement are applicable to the research and development cluster.

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- A. Activities Allowed/Unallowed
- B. Allowable Costs/Cost Principles
- C. Cash Management
- D. Davis-Bacon Act
- E. Eligibility
- F. Equipment and Real Property Management
- G. Matching, Level of Effort, Earmarking
- H. Period of Availability of Federal Funds
- I. Procurement and Suspension and Debarment
- J. Program Income
- K. Real Property Acquisition and Relocation Assistance
- L. Reporting
- M. Subrecipient Monitoring
- N. Special Tests and Provisions

The Statement of Position 98-3, “Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards,” published by the American Institute of Certified Public Accountants, provides guidance on auditor responsibilities for conducting audits according to the Single Audit Act and OMB Circular A-133 (the American Institute of Certified Public Accountants converted the Statement of Position into an audit guide in May 2003). In general, the Statement of Position 98-3 provides auditors with an understanding of the unique planning, performance, and reporting considerations for single audits performed under GAS. In addition, the Statement of Position 98-3 uses summary tables and detailed discussions to provide the auditor with an understanding of the additional general, fieldwork, and reporting requirements under GAS, including the additional standards relating to quality control systems, continuing professional education, audit documentation, audit followup, and reporting.

The Statement of Position 98-3 emphasizes that when planning an audit to meet the requirements of OMB Circular A-133, several factors should be considered in addition to those ordinarily associated with an audit of financial statements in accordance with Generally Accepted Auditing Standards and GAS. The factors include but are not limited to:

- Determining that the Schedule of Expenditures of Federal Awards is presented fairly in relation to the financial statements;
- Determining major programs for audit using a risk-based approach;
- Determining applicable and material compliance requirements;
- Gaining an understanding of internal control over Federal programs;
- Testing internal control over major programs;
- Determining compliance with laws, regulations, and the provisions of contract or grant agreements that have a direct and material effect on each major program; and
- Satisfying the additional requirements of the Single Audit Act and OMB Circular A-133 regarding audit documentation, audit followup, and reporting.

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## **Appendix B. Coordinated Audit Responsibilities**

PwC and DCAA coordinated the audit responsibilities for the FY 2001 OMB Circular A-133 audit of IDA. PwC performed all audit work related to the financial statements. DCAA performed all audit work related to the major program (including compliance with all 14 compliance requirements referenced in Appendix A). The following is a breakdown of audit responsibilities:

<b>Required Areas Under OMB Circular A-133</b>	<b>Audit Responsibilities</b>	
	<b>DCAA</b>	<b>PwC</b>
Opinion on Financial Statements		X
Compliance and Internal Controls Over Financial Reporting		X
Opinion on the Schedule of Expenditures of Federal Awards	X	
Internal Control Over Compliance for Major Programs	X	
Compliance With Requirements for Major Programs and Related Opinion	X	
Schedule of Findings and Questioned Costs	X	
Preparation of the Data Collection Form	X	X

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition, Technology, and Logistics  
Director, Defense Procurement and Acquisition Policy

### **Other Defense Organizations**

Director, Defense Contract Audit Agency  
Assistant Director, Policy and Plans, Defense Contract Audit Agency  
Branch Manager, Defense Contract Audit Agency Chesapeake Bay Branch  
Director, Defense Contract Management Agency  
Administrative Contracting Officer, Defense Contract Management Agency Baltimore  
Director, National Security Agency

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Auditor General of the Air Force

### **Department of the Army**

Assistant Secretary of the Army (Financial Management and Comptroller)  
Auditor General, U.S. Army Audit Agency

### **Non-Government Organizations**

Board of Trustees, The Institute for Defense Analyses  
Audit Committee, The Institute for Defense Analyses  
Treasurer and Director of Finance, The Institute for Defense Analyses  
Controller, The Institute for Defense Analyses  
Partner in Charge, PricewaterhouseCoopers, LLP  
Audit Manager, PricewaterhouseCoopers, LLP

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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Efficiency, Financial Management, Committee on Government Reform  
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform  
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform



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# Defense Contract Audit Agency Comments



IN REPLY REFER TO

820.1/6171

CHESAPEAKE BAY BRANCH OFFICE  
MID-ATLANTIC REGION  
DEFENSE CONTRACT AUDIT AGENCY  
DEPARTMENT OF DEFENSE  
10025 Governor Warfield Pkwy, Suite 200  
Columbia, Maryland 21044-3329  
410-964-2070  
410-997-0509 (FAX)  
[DCAA-FAO6171@dcaa.mil](mailto:DCAA-FAO6171@dcaa.mil)

June 30, 2004

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDIT  
POLICY AND OVERSIGHT, DEPARTMENT OF DEFENSE  
INSPECTOR GENERAL

ATTENTION: Patricia A Brammin, Assistant Inspector General for Audit Policy and Oversight

SUBJECT: Response to Discussion Draft Report on the Quality Control Review of PricewaterhouseCoopers, LLP and Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the Institute for Defense Analyses, Fiscal year Ended September 28, 2001 (Project No. D-2003-OC-0120)

Thank you for the opportunity to respond to the subject discussion draft report and the results of the evaluation reported therein. Our responses to the individual report recommendations follow:

**IG Recommendation A – Audit Planning and Performance**

**Recommendation No. 1.** We recommend that the Branch Manager, Defense Contract Audit Agency, Chesapeake Bay Branch Office, perform additional audit procedures for the Office of Management and Budget Circular A-133 audit report for the Institute of Defense Analyses for FY 2001 to determine whether IDA is in compliance with Federally Funded Research and Development Centers sponsoring agreement requirements and if the Schedule of Federal Expenditures is complete, and provide our office with the supporting documentation. The report should be revised, if needed, based on the results of additional audit work.

**DCAA.** Concur. We will perform additional audit procedures to review the sponsoring agreements for special tests and provisions and take additional actions if the results of that review so indicate. We will also perform additional analysis of the differences between the SEFA and the financial statements that were identified in the audit to determine if the SEFA is properly stated and the contractor is in compliance with the provisions of the sponsoring agreement.

**Recommendation No. 2.** We recommend that the Branch Manager, Defense Contract Audit Agency, Chesapeake Bay Branch Office, perform additional procedures to determine if the Program Income and Subrecipient Monitoring requirements are applicable. Based on the results

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SUBJECT: Response to Discussion Draft Report on the Quality Control Review of PricewaterhouseCoopers, LLP and Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the Institute for Defense Analysis, Fiscal year Ended September 28, 2001 (Project No. D-2003-OC-0120)

of the additional audit work, we further recommend that any appropriate procedures be performed and the report revised as necessary.

**DCAA.** Concur. We will perform additional audit procedures, including a review of all income sources in the financial statements, to determine if our original assessment is appropriate that the Program Income compliance supplement did not apply. If these additional audit procedures conclude that the Program Income supplement does apply, we will perform additional procedures to assure the contractor's compliance with the supplement and revise the report if necessary

Concerning the applicability of Subrecipient monitoring, we will review a sample of the 21 subcontracts to provide a clear determination of the existence or nonexistence of Subrecipients and perform additional audit steps if it is found that the supplement is applicable and modify the report, if necessary.

#### **IG Recommendation B – Documentation of Audit Work**

**IG Recommendation B.** We recommend that to improve future audits, the Branch Manager, Defense Contract Audit Agency, Chesapeake Bay Branch Office, ensure adequate documentation of judgmental sampling plans and audit work conducted to achieve the objectives of Office of Management and Budget Circular A-133 audits. In addition, we recommend that the Branch Manager ensure that draft audit reports are cross-referenced in accordance with Defense Contract Audit Agency guidance.

**DCAA.** Concur. During the current and previous fiscal years, we have made a conscious effort to reinforce the concerns represented in the IG conditions. For example, our staff conferences have placed a strong emphasis on audit documentation, including the issue of documentation of sampling plans. We have attached to this response agendas from recent staff conferences which detail the subject matter. We agree with the IG findings that future A-133 audits need to be better documented and believe that the recent training will provide a basis for that to occur.

Regarding the cross referencing of draft audit reports, while our current policy and procedures require that a copy of the cross-referenced draft audit report be included in the work paper file, we will review our current procedures and take steps necessary to ensure that they are followed and that a copy is maintained in the audit working papers

#### **Recommendation C - Reporting Inconsistent with OMB A-133 Requirements**

**IG Recommendation C.** We recommend that the Branch Manager, Defense Contract Audit Agency, Chesapeake Bay Branch Office, reissue the Office of Management and Budget

6171 820.1

SUBJECT: Response to Discussion Draft Report on the Quality Control Review of PricewaterhouseCoopers, LLP and Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the Institute for Defense Analysis, Fiscal year Ended September 28, 2001 (Project No. D-2003-OC-0120)

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**SUBJECT:** Response to Discussion Draft Report on the Quality Control Review of PricewaterhouseCoopers, LLP and Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the Institute for Defense Analysis, Fiscal year Ended September 28, 2001 (Project No. D-2003-OC-0120)

Circular A-133 audit report for the Institute of Defense Analysis for FY 2001 to accurately reflect the results and conclusions of the audit and include the required language

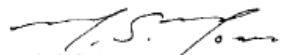
**DCAA.** Concur in principle. The term "financial records" was improperly used in place of the term "financial statements" in the audit report. Additionally, the qualification related to a CAS noncompliance where the cost impact can not be reasonably determined is outlined in DCAAM 7640.1 Chapter 10-214a. The DCAA auditors followed that guidance improperly because the impact could be reasonably determined and, in fact, was included in the audit results.

Regarding the re-issuance of the report, at this date, we are two years from the issuance of the original DCAA audit report and IDA's filing with OMB. It is our opinion that the usefulness of modifying and reissuing that report at this time is uncertain. Based on discussions we have had with the DoDIG, should the appropriate level within IDA (Audit Committee or Board of Directors) agree that no useful purpose would be served by reissuing the report, we will not re-issue the report, but document the changes to IDA.

We have spoken with Mr. Dean Graves, IDA Treasurer, who has concurred with our proposed action and will obtain additional concurrence from the IDA Board of Directors or the Audit Committee. We will provide the DoDIG with written confirmation of the contractor's concurrence.

Once we have completed the additional actions as indicated above, we will provide copies of the appropriate work papers and documents to the DoDIG. We anticipate that all actions will be completed by July 31, 2004.

Questions regarding this memorandum should be directed to Mr. Mark S. Moser, Branch Manager of the Chesapeake Bay Branch Office.



Mark S. Moser  
Branch Manager  
Chesapeake Bay Branch Office

**Copy Furnished:**

Janet Stern, DoDIG  
PQA (Janis Lang)

Enclosures: a/s

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# Institute for Defense Analyses Comments

07/01/2004 14:24 FAX 7038452281

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INSTITUTE FOR DEFENSE ANALYSES

C. Dean Graves, Jr., Treasurer and Director of Finance

July 1, 2004

Inspector General  
Department of Defense  
400 Army Navy Drive, Room 1029  
Arlington, V.A. 22202-4704

Attn: Laura Rainey

Dear Ms. Rainey,

Regarding your Discussion Draft Report dated June 1, 2004 in which it was recommended that IDA ensure that future Schedules of Expenditures of Federal Awards include the appropriate notes to meet the requirements of OMB Circular A-133.

We concur with your recommendation and have attached hereto an example of the Significant Accounting Policies statement we will include with future submissions, beginning with the FY 2003 A-133.

Sincerely,

A handwritten signature in black ink, appearing to read "C. Dean Graves".

C. Dean Graves,  
Treasurer

Attachment: Summary of Significant Accounting Policies  
C:/word/A-133IG.doc

4850 Mark Center Drive / Alexandria, Virginia 22311-1882  
703-845-2079 / 703-845-2281 fax / dgraves@ida.org

**INSTITUTE FOR DEFENSE ANALYSES**

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the Institutes Federal contract activity and is presented on the accrual basis of accounting. The information in this Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## **Evaluation Team Members**

The Deputy Inspector General for Inspections and Policy, Office of the Inspector General of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

Carolyn R. Davis  
Janet Stern  
Laura A. Rainey  
Monica M. Harrigan  
Ashley Harris